

this section), and not out of the earnings and profits of the taxable year in which the distribution is actually paid (or treated as paid under section 852(b)(7)).

(v) *Receipt by shareholders.* Except as provided in section 852(b)(7), a retroactive dividend shall be included in the gross income of the shareholders of the regulated investment company for the taxable year in which the dividend is received by them.

(vi) *Foreign tax election.* If a regulated investment company to which section 853 (relating to foreign taxes) is applicable for a retroactive election year elects to treat a dividend paid (or treated as paid under section 852(b)(7)) during the taxable year as a retroactive dividend, the shareholders of the regulated investment company shall consider the amounts described in section 853(b)(2) allocable to such distribution as paid or received, as the case may be, in the shareholder's taxable year in which the distribution is made.

(vii) *Example.* The provisions of this paragraph (j)(4) may be illustrated by the following example:

Example. X is a regulated investment company that computes its income on a calendar year basis. No election is in effect under section 4982(e)(4). X has the following income for 1988:

FOREIGN CURRENCY GAINS AND LOSSES

Gains and Losses

Jan. 1–Oct. 31—100
Nov. 1–Dec. 31—(75)

CAPITAL GAINS AND LOSSES

Jan. 1–Oct. 31—short term, 100; long term, 100
Nov. 1–Dec. 31—short term, 50; long term, (100)

(A) X had investment company taxable income of \$175 and no net capital gain for 1988 for taxable income purposes. X distributed \$175 of investment company taxable income as an ordinary dividend for 1988.

(B) If X makes a retroactive election under this section to defer the entire \$75 post-October currency loss and the entire \$50 post-October capital loss for the post-October period of its 1988 taxable year for purposes of computing its taxable income, that deferral increases X's investment company taxable income for 1988 by \$25 (due to an increase in foreign currency gain of \$75 and a decrease in short-term capital gain of \$50) to \$200 and increases the excess described in section 852(b)(3)(A) for 1988 by \$100 from \$0 to \$100.

The amount that X may treat as a retroactive ordinary dividend is limited to \$25, and the amount that X may treat as a retroactive capital gain dividend is limited to \$100.

(5) *Certain distributions may be designated retroactively as capital gain dividends.* To the extent that a regulated investment company designated as capital gain dividends for a taxable year less than the maximum amount permitted under paragraph (e) of this section for that taxable year, the regulated investment company may designate an additional amount of dividends paid (or treated as paid under sections 852(b)(7) or 855, or paragraph (j)(4) of this section) for the taxable year as capital gain dividends, notwithstanding that a written notice was not mailed to its shareholders within 60 days after the close of the taxable year in which the distribution was paid (or treated as paid under section 852(b)(7)).

(k) *Effective date.* the provisions of this section shall apply to taxable years ending after October 31, 1987.

[T.D. 8287, 55 FR 3213, Jan. 31, 1990; 55 FR 7891, Mar. 6, 1990; 55 FR 11110, Mar. 26, 1990. Redesignated and amended by T.D. 8320, 55 FR 50176, Dec. 5, 1990; 56 FR 2808, Jan. 24, 1991; 56 FR 8130, Feb. 27, 1991]

§ 1.852-12 Non-RIC earnings and profits.

(a) *Applicability of section 852(a)(2)(A)—(1) In general.* An investment company does not satisfy section 852(a)(2)(A) unless—

(i) Part I of subchapter M applied to the company for all its taxable years ending on or after November 8, 1983; and

(ii) For each corporation to whose earnings and profits the investment company succeeded by the operation of section 381, part I of subchapter M applied for all the corporation's taxable years ending on or after November 8, 1983.

(2) *Special rule.* See section 1071(a)(5)(D) of the Tax Reform Act of 1984, Public Law 98-369 (98 Stat. 1051), for a special rule which treats part I of subchapter M as having applied to an investment company's first taxable year ending after November 8, 1983.

(b) *Applicability of section 852(a)(2)(B)*—(1) *In general.* An investment company does not satisfy section 852(a)(2)(B) unless, as of the close of the taxable year, it has no earnings and profits other than earnings and profits that—

(i) Were earned by a corporation in a year for which part I of subchapter M applied to the corporation and, at all times thereafter, were the earnings and profits of a corporation to which part I of subchapter M applied;

(ii) By the operation of section 381 pursuant to a transaction that occurred before December 22, 1992, became the earnings and profits of a corporation to which part I of subchapter M applied and, at all times thereafter, were the earnings and profits of a corporation to which part I of subchapter M applied;

(iii) Were accumulated in a taxable year ending before January 1, 1984, by a corporation to which part I of subchapter M applied for any taxable year ending before November 8, 1983; or

(iv) Were accumulated in the first taxable year of an investment company that began business in 1983 and that was not a successor corporation.

(2) *Prior law.* For purposes of paragraph (b) of this section, a reference to part I of subchapter M includes a reference to the corresponding provisions of prior law.

(c) *Effective date.* This regulation is effective for taxable years ending on or after December 22, 1992.

(d) For treatment of net built-in gain assets of a C corporation that become assets of a RIC, see § 1.337(d)-5T.

[T.D. 8483, 58 FR 43798, Aug. 18, 1993; 58 FR 49352, Sept. 22, 1993; T.D. 8872, 65 FR 5777, Feb. 7, 2000]

§ 1.853-1 Foreign tax credit allowed to shareholders.

(a) *In general.* Under section 853, a regulated investment company, meeting the requirements set forth in section 853(a) and paragraph (b) of this section, may make an election with respect to the income, war-profits, and excess profits taxes described in section 901(b)(1) which it pays to foreign countries or possessions of the United States during the taxable year, including such taxes as are deemed paid by it

under the provisions of any income tax convention to which the United States is a party. If an election is made, the shareholders of the regulated investment company shall apply their proportionate share of such foreign taxes paid, or deemed to have been paid by it pursuant to any income tax convention, as either a credit (under section 901) or as a deduction (under section 164(a)) as provided by section 853(b)(2) and paragraph (b) of § 1.853-2. The election is not applicable with respect to taxes deemed to have been paid under section 902 (relating to the credit allowed to corporate stockholders of a foreign corporation for taxes paid by such foreign corporation).

(b) *Requirements.* To qualify for the election provided in section 853(a), a regulated investment company (1) must have more than 50 percent of the value of its total assets, at the close of the taxable year for which the election is made, invested in stocks and securities of foreign corporations, and (2) must also, for that year, comply with the requirements prescribed in section 852(a) and paragraph (a) of § 1.852-1. The term “value”, for purposes of the first requirement, is defined in section 851(c)(4). For the definition of foreign corporation, see section 7701(a).

§ 1.853-2 Effect of election.

(a) *Regulated investment company.* A regulated investment company making a valid election with respect to a taxable year under the provisions of section 853(a) is, for such year, denied both the deduction for foreign taxes provided by section 164(a) and the credit for foreign taxes provided by section 901 with respect to all income, war-profits, and excess profits taxes (described in section 901(b)(1)) which it has paid to any foreign country or possession of the United States. See section 853(b)(1)(A). However, under section 853(b)(1)(B), the regulated investment company is permitted to add the amount of such foreign taxes paid to its dividends paid deduction for that taxable year. See paragraph (a) of § 1.852-1.

(b) *Shareholder.* Under section 853(b)(2), a shareholder of an investment company, which has made the election under section 853, is, in effect,